

2012

West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

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West Michigan-Grand Rapids Commercial Real Estate Review and Forecast

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Colliers International | West Michigan

Grand Rapids | Industrial Market

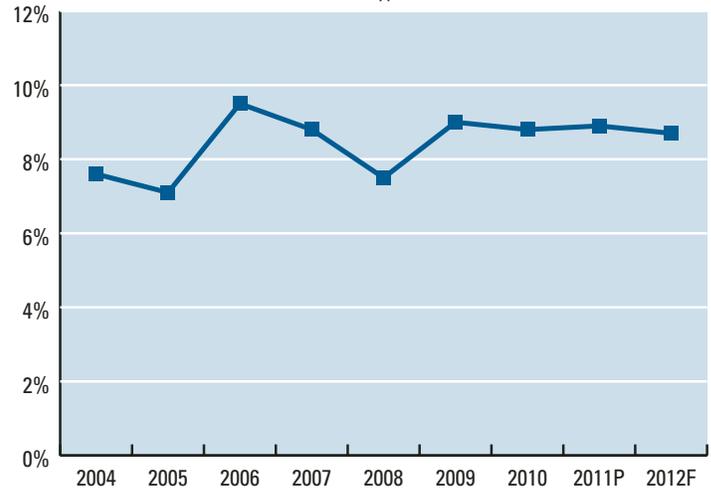
As we continue to traverse the uncertain waters of the commercial real estate market, we look for trends to emerge that foreshadow what the future has in store. The industrial sector of the market has been on the forefront of such trends throughout much of the economic downturn and is a great barometer for how the rest of the local market will continue to react and recover. In 2011, we continued to see market perception trail market reality. Users as well as investors are still cautious, despite the bottoming-out that we have seen over the past twelve months. Rates and occupancy have hit all-time lows; however, we believe the worst is now behind us.

The industrial segment of the market has seen an underrated recovery this year. Competition has begun again as quality space is as highly sought after as ever. The norms of the past are now more than just a distant memory. Activity in the market has increased and tenants are starting to see rates firm up and landlords offer fewer incentives. More than ever, those with market knowledge through this time will be better positioned to take advantage of this changing paradigm.

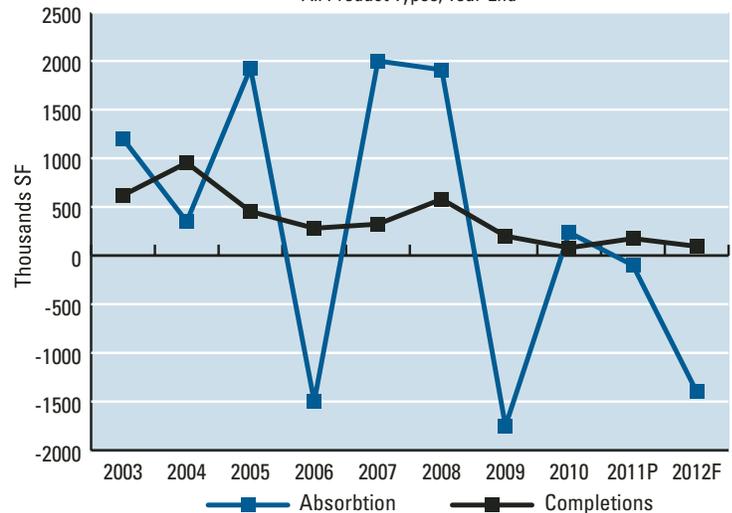
As always, each sector of the market behaves differently. Southern Grand Rapids continues to see the most industrial activity; however, quality space all over the market is being actively considered. Manufacturing continues to lead the comeback, with demand overflowing into warehouse product as well. One result of the recent economy is more efficiency. Industrial users are operating as effectively as ever, and that has been a catalyst for much of the movement in the market. Companies are looking for opportunities to take advantage of, not only their increased productivity, but the lingering incentives still left in the market. We see now as a great time to re-evaluate needs and act accordingly.

This past year has seen some major deals in our region. Lumbermen's, Inc. moved into 198,000 square feet of space in Byron Center, while ATEK Medical relocated and expanded, and R.L. Plastics took nearly 100,000 square feet on Expressway Drive. Close to 100 acres of land was sold in a deal that was motivated by the presence of a rail spur that made it economically beneficial for the purchaser to acquire the land. In today's ever-changing market, unique solutions to real estate problems are how many deals get done. In addition, banks are beginning to loosen their purse strings and funding is becoming more attainable. As forecasted at the beginning of last year, we see these banks continuing to dispose of REO properties, some even at a significant loss. We maintain the theory of two markets: Class A industrial space trades at a premium, while distressed or functionally obsolete space garners much less attention.

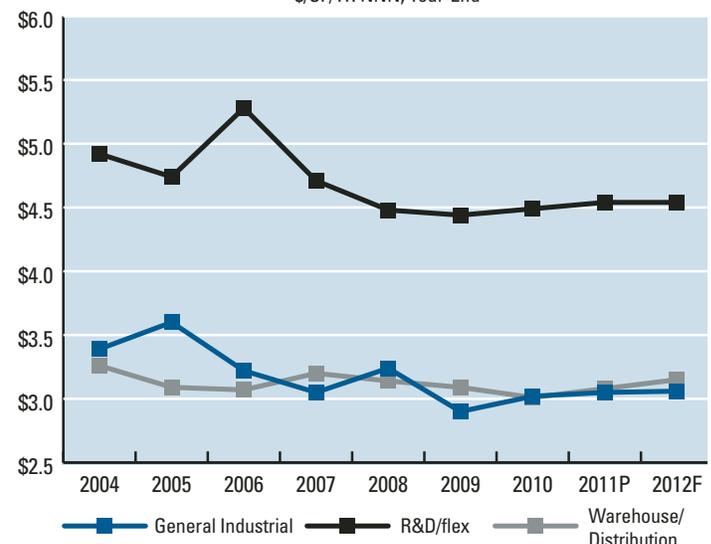
Vacancy Rates
All Product Types Year-End

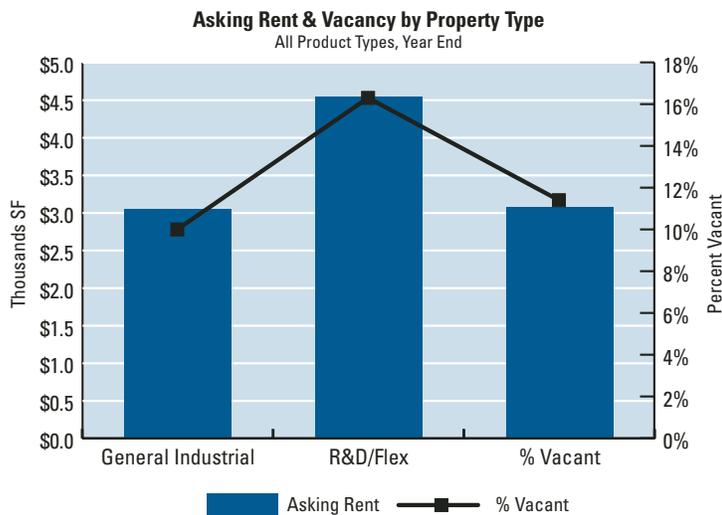


Absorption vs. Completions
All Product Types, Year-End



Asking Rental Rates
\$/SF/YR NNN, Year-End





Grand Rapids has been a bright spot in an otherwise dark couple of years for the State of Michigan. While the state as a whole has seen rising unemployment and declining residential population, Grand Rapids has continued to buck that trend. The magazine *RelocateAmerica* recently gave the city the distinction of the number two best places to live in America. The area has seen its population grow by nearly 10% over the past five years and is projected to add another 20,000 or so residents by 2015. Furthermore, unemployment in the area has dropped from 9% in November of 2010 to 6.5% in November of 2011.

Through three quarters, we have seen positive absorption of over a half million square feet in the industrial sector. This number will end 2011, however, as Amway readies to vacate their nearly 700,000 square foot facility on Spaulding Avenue. Although this seems like negative news for the local economy, the move was described by the company as a “strategic adjustment” and will eventually add jobs while simply relocating and refocusing much of their production. Another project to keep an eye on is the demolition of the General Motors plant on 36th Street that is currently under way. We expect to see this job completed by the second quarter of 2012 and look to find out what redevelopment plans will be in place. This nearly 2 million square foot facility has been in need of redevelopment for years and the tax incentives that are now available have finally gotten the project off the ground. Conversely, there have been some additions to the market inventory as well. Auto supplier Lacks Enterprises completed 82,300 square feet of additions to two of their sites this year, while Lighthouse Foods added approximately 43,000 square feet on the southeast side of town. We look for new construction to remain steady at a very moderate rate going forward. Instead of new development, we expect most of the industrial construction to come in the form of additions and reconfigurations. Building owners must consider the replacement costs involved in moving, and many are choosing to be creative with what they have rather than look for new space.

We predicted last year that manufacturing would lead Grand Rapids through these trying times, and we continue to echo that sentiment. West Michigan is known for its combination of entrepreneurial talent, skilled labor force, and access to manufacturers; going forward into 2012 we see this advantage to only increase. While the recovery is still flying under the radar, we continue to see signs of positive activity. In the Midwest region, manufacturing technology orders are up nearly 49% year-over-year, and we predict further investment in the industry. As we all know, it will take time and effort to build back up to historical norms; however, such investment in technology is a sign that businesses are ready to spend money again and have hope for the future.

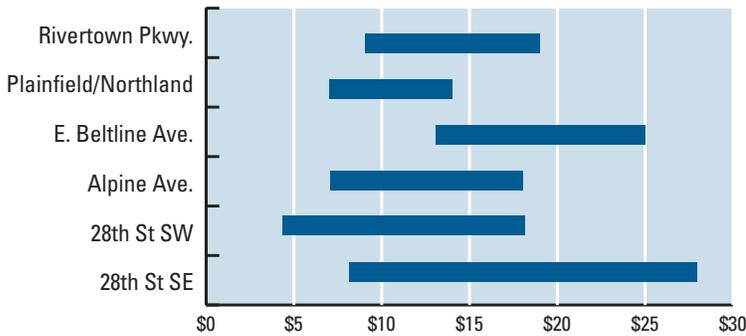
Going forward, the gap between “trophy” Class A properties and “train wreck” Class C properties looks to only grow. We expect to see more and more transactions formed with creative solutions. More than ever, it will be important for brokers, landlords, and tenants to work together to get deals across the finish line. Quality inventory will continue to decrease, and, subsequently, tenants will look to lock-in their spaces at current market rates. 2012 should be a good indicator for the speed of recovery. As the end of 2011 showed a good amount of activity, we see 2012 as a year to rebuild the reputation and perception of the market.

Grand Rapids | Investment Market

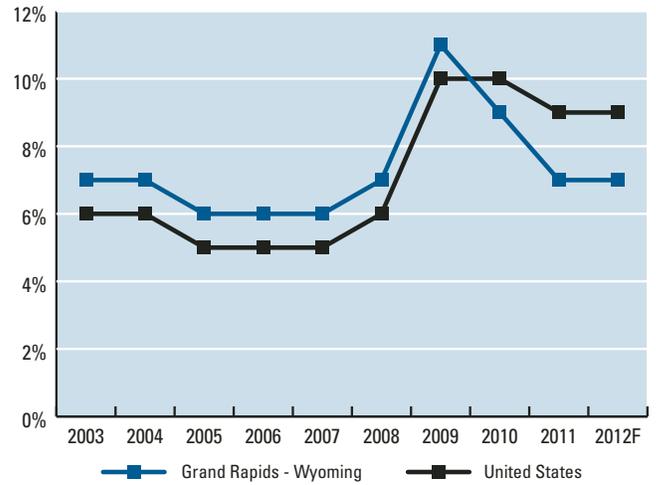
2011 began where 2010 ended with increasing activity level in the investment real estate sector and a slow gradual valuation improvement in most property types. The West Michigan market saw a return to a more “normalized” transaction activity level, although there remained a higher percentage of transactions that were spurred by distressed or bank-owned transactions than in years past. A more confident atmosphere permeated the market in all facets, including investor interest, financing availability, and seller confidence. Generally, values increased throughout the year, and capitalization rates have continued a slow and gradual downward adjustment (signifying higher values). Prices remain below the averages of 4 and 5 years ago, having been pulled down by a higher percentage of distressed assets. However, long term net leased investment sales have recovered much of the value lost during the great recession, and capitalization rates for net leased, credit tenants are again near historic lows.

The recovery of the investment real estate market has been spurred in part by interest rates that have continued to decrease and are at historically low levels. Additionally, there is increasing availability of capital sources, including local lenders, national life insurance companies, and even the return of the CMBS market. The low interest rate levels and increasing financing options have created a surge of new investors seeking opportunities in the market. Investors have primarily been searching for value-added investments available at prices well below replacement costs, or long-term net leased investments demonstrating a stable and predictable

Asking Rent by Corridor
\$/SF/YR NNN, Year-End



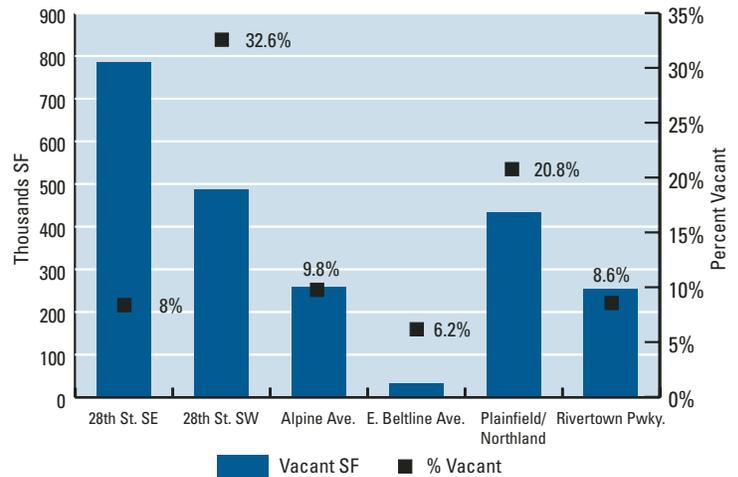
Unemployment Rate - Grand Rapids - Wyoming Metro vs. U.S.
Not Seasonally Adjusted



cash flow. Throughout 2011 there was a shortage of quality investment opportunities. In fact, many properties that have traded hands have been distressed assets with little or no cash flow in place at the time of sale. There remains a supply of distressed assets with challenges in place, but also a return of a more traditional investment market.

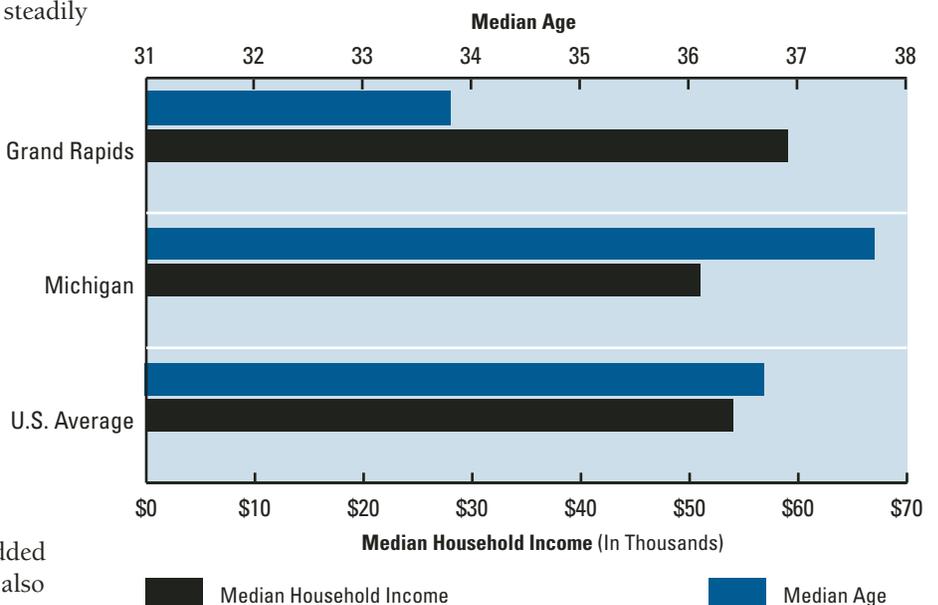
The most active property type in 2011 was the multi-family market. This is a fundamentally healthy market which has seen the biggest improvement since the recent recession. Rental rates have increased; vacancies have decreased; and the market dynamics continue to show a consumer more interested in renting than owning for the foreseeable future. In West Michigan, we have seen a lack of new quality multi-housing options, which has created upward pressure on occupancy and rental rates at existing properties. The downtown and fringe neighborhoods have been particularly stable as the growing population of students and young professionals prefer to be located in an urban environment. We anticipate 2012 will continue a national trend of increasing buyer interest in the multi-family market. In West Michigan we will continue to see a lack of high quality product available on the market. Those select assets that do go to market should see a very strong level of interest from potential purchasers and steadily rising valuations.

Vacant SF & Vacancy Rates

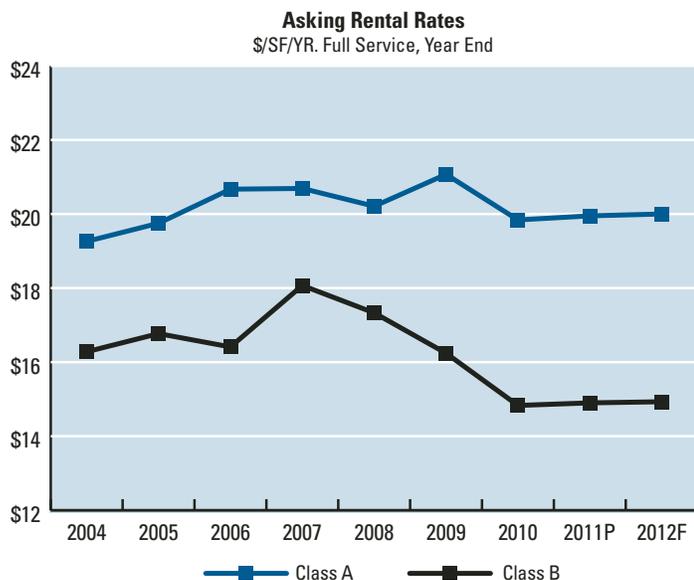
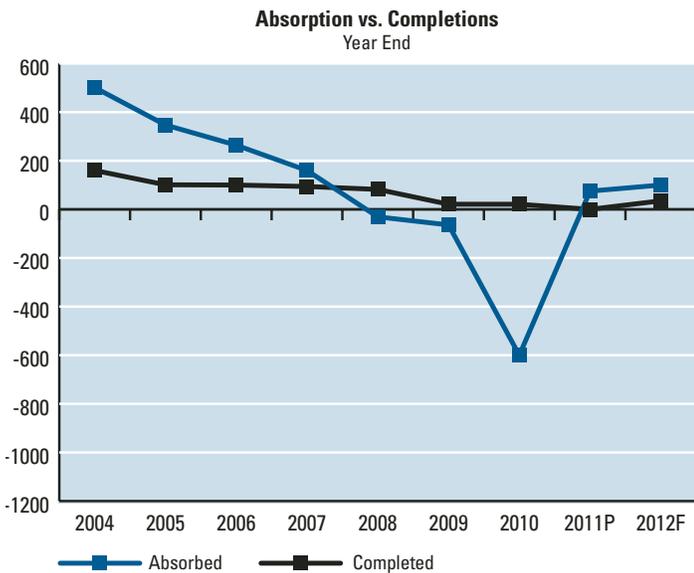
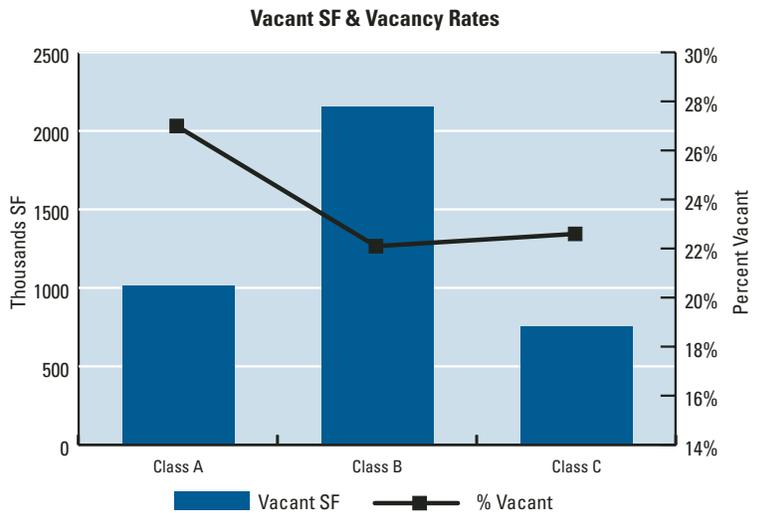
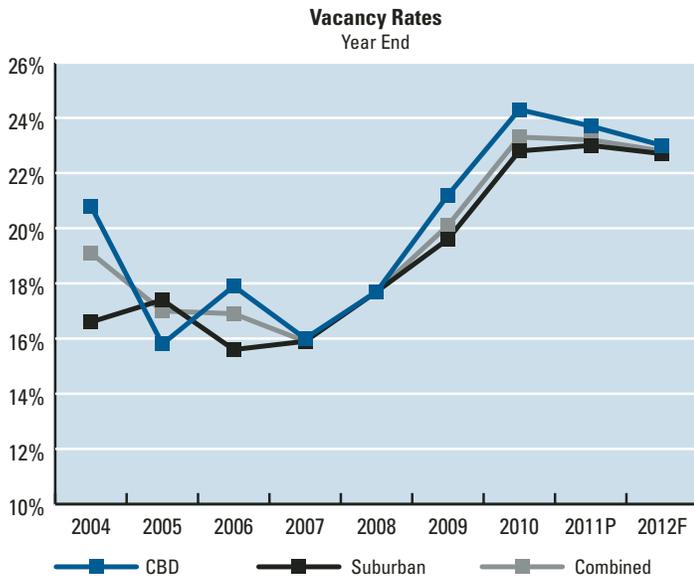


The industrial segment continues to strengthen. The fundamentals point to a tightening marketplace, increasing rents and positive absorption. We expect to see continued interest in stable long-term leased industrial investment properties. Buyer interest will be particularly focused on manufacturing facilities with bolted down equipment, high ceilings, and adequate power, as this segment has seen the greatest demand and shows the highest level of long-term stability for West Michigan manufacturers and, in turn, investors.

Median Age and Income



The office market remains focused on value-added transactions or medical office sales. There has also



been more demand for office properties located in the CBD over the suburbs. The vast majority of the suburban office sales have been distressed in nature. Additionally, there have been limited numbers of transactions from out-of-state investors, a component that buoyed sales prices in past years that simply was not evident in 2011. We anticipate increasing activity from out-of-state investors in 2012 as the Michigan recovery continues to outpace the performance of the rest of the nation yet offers returns above that of other real estate markets around the country.

Generally, the retail market was characterized by relatively few transactions, the majority of which were at some level of distress. The market appears to have bottomed and has begun a slow upward climb. We expect to see a strengthening of the retail sales market in 2012, particularly for well-located premium centers. Tenants remain active, and retail same store sales have generally reported a positive tone in West Michigan. Single tenant, new lease retail investments, however, stands in stark contrast to the rest of the retail investment market. Single tenant assets have shown strong pricing and demand from both local and national investors. Properties located in Class A locations with strong tenants are able to achieve valuations nearing historic highs.

In 2012 we anticipate a healthier level of transaction volume. The market will be characterized by fewer distressed sales and a return to a more traditional arm's length seller and buyer. Additionally we expect to see increasing demand and participation from out-of-state investors. We also see a number of sellers interested in taking advantage of the strength of the single-tenant market through either a sale and leaseback transaction, or a blend and extend of an existing lease in order to sell into the currently strong single-tenant sales market.

In 2012 we will see a handful of high quality, high profile lender owned pieces of investment real estate that will trade hands. To date, much of the lender owned product has been

subpar or older and significantly undervalued real estate. The values attributed to some of the higher profile distressed real estate will have a strong impact on pricing trends in West Michigan.

Grand Rapids | Office Market

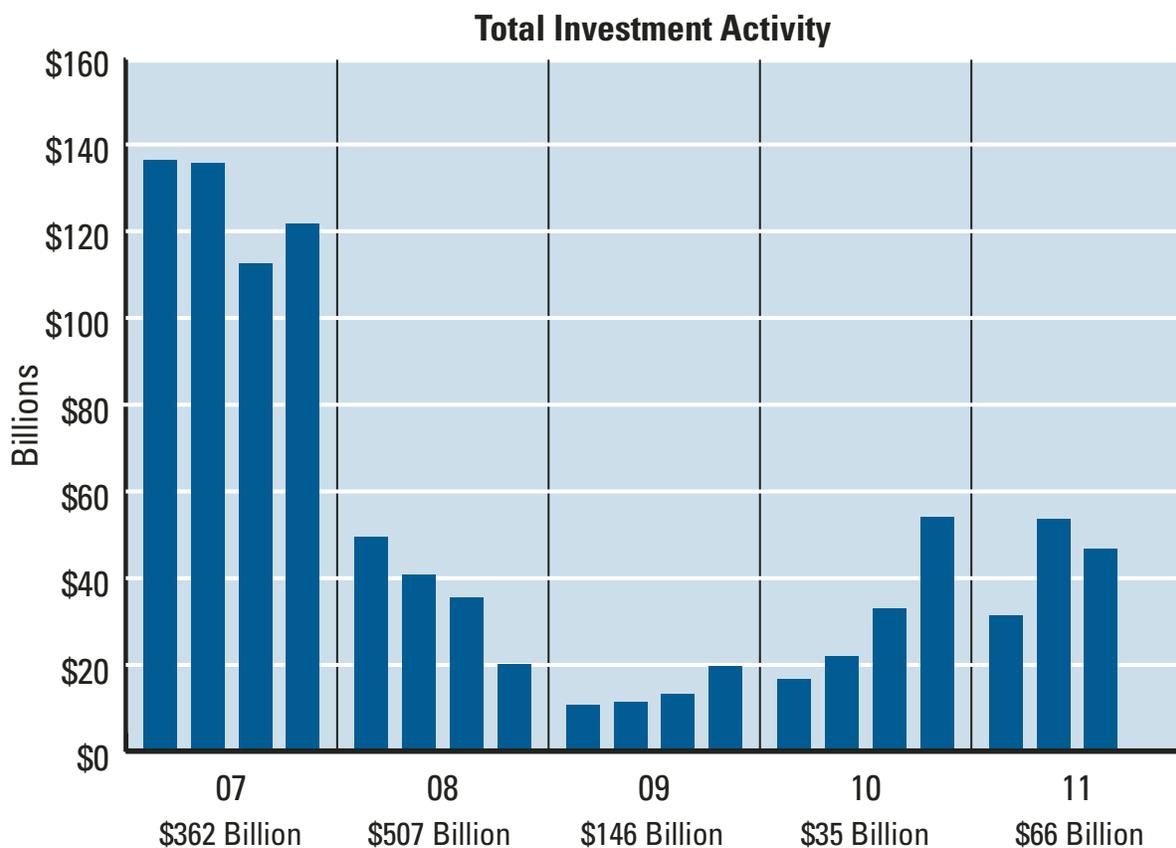
Grand Rapids made some national headlines over the summer as it came in at number two on *RelocateAmerica's* top 10 places to live in the entire nation. Our city was chosen because of its solid schools and strong economy. "It's got the best of everything in a smaller large city," said Steve Nickerson, president of *RelocateAmerica*. Also, a survey by the employment services firm ManpowerGroup announced Grand Rapids, Michigan as having the country's most optimistic forecast for summer hiring in a metropolitan area. "This is the strongest outlook we've seen in the Grand Rapids-Wyoming market in almost three years," says Melanie Holmes, a vice president at ManpowerGroup. This does not come as a surprise as West Michigan has diversified over the last decade and has recovered economically more quickly than other parts of Michigan, and the nation.

Employment is a key statistic and one of the driving factors of office real estate. Throughout the year, employment numbers in West Michigan have fluctuated some but, for the most part, have been positive. According to the Bureau of Labor Statistics, the Grand Rapids area unemployment rate dropped two and a half percentage points year-to-date falling

to 6.5% in November of 2011 compared to 9% a year earlier. The unemployment number also decreased from 7.9% to 6.5% between September and November; these strong employment numbers should help fuel office leasing activity going into 2012.

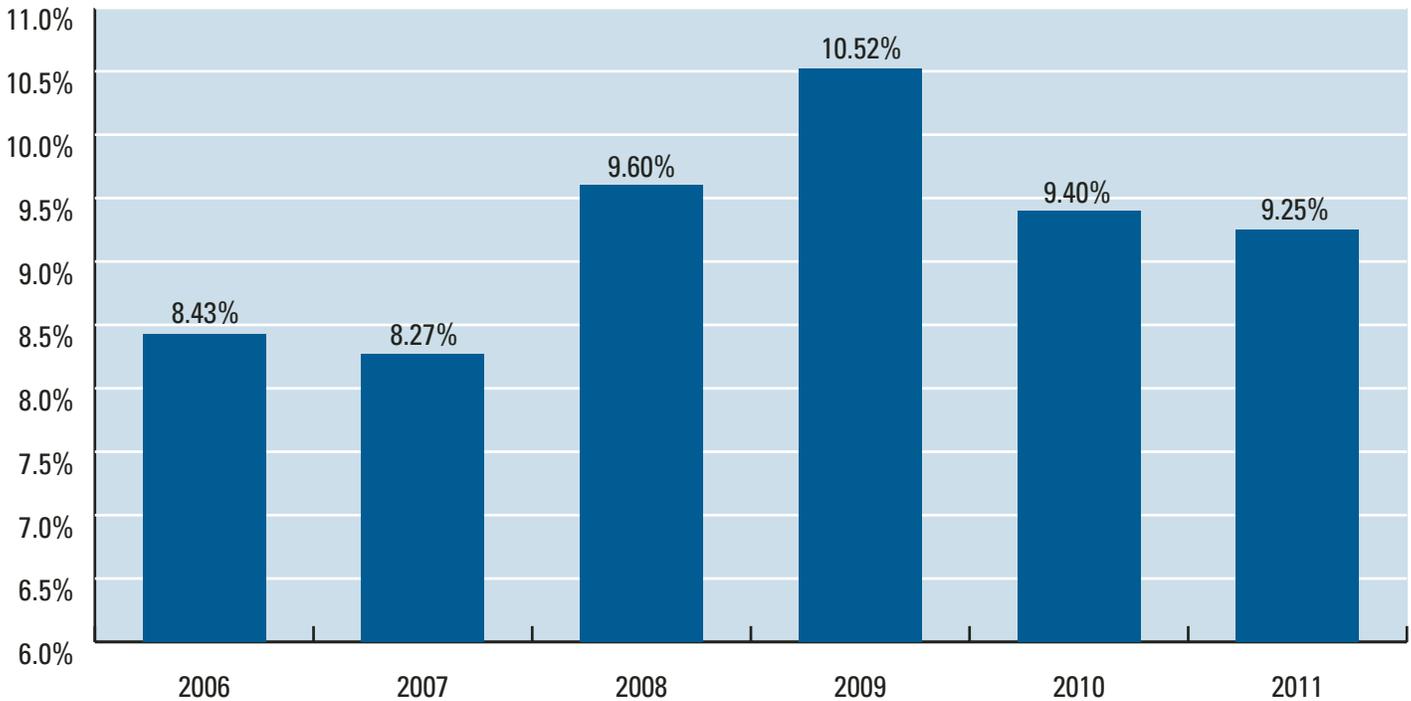
The office market is not as unpredictable today as it has been in the last couple of years and, for the most part, the panic is over. There has been a flight to quality as more tenants have been able to find newer and better located space at less expensive rents than in previous years. Companies are also getting lean and right sizing in an effort to make more efficient use of their office space. In spite of this, the Grand Rapids office market started the year with three straight quarters of positive absorption, and the fourth quarter is expected to finish the year repeating that trend. The third quarter posted a positive absorption of 55,638 square feet, which is the largest positive quarterly absorption number since the second quarter of 2007.

The suburban office market saw strong activity throughout the year and an uptick in the number of transactions completed. The southeastern corridors remain the strongest and have seen the bulk of the positive absorption for the suburban office submarket. Landlords have dropped their rates and are doing turn-key build-outs to attract new companies and keep existing tenants. Vacant suburban office space has decreased in the past 12 months, which is good



Source: Real Capital Analytics, www.rcanalytics.com

Average West Michigan Capitalization Rates



Reflects average cap rates for all investment property sales completed by Colliers International in West Michigan

news following a slow 2010. Suburban transactions of note in 2011 include a lease by Intelligrated at 3033 Orchard Vista Drive for over 16,500 square feet, and almost 12,000 square feet leased to Raymond James at 2060 East Paris Avenue. Expect more of the same for suburban office in the next year: a steady dose of slow but decreasing vacancy and positive absorption. The southeast corridors will again be the dominant suburban submarkets because of the amount of inventory, quality of product, and proximity to the airport compared to the other suburban submarkets. Although suburban rental rates trended downward slightly in 2011, signs show that those rates are firming up. Rental rates could hit bottom in 2012 and potentially even see a slight increase.

The Central Business District (CBD) continued to be the “hub” of leasing activity in Grand Rapids over the past year. Competitive lease rates and the cultural investments made in the CBD have contributed in attracting tenants to the heart of the city. Because of this activity, the downtown office market saw a decrease in vacancy percentage each quarter of 2011. Rental rates in the CBD have stabilized throughout the year, but we are still far from the once historical highs. Some of the noteworthy leases that were signed downtown in 2011 include BDO USA, LLP 44,500 square foot lease at 200 Ottawa Avenue, Smith Haughey Rice & Roegge’s 26,600 square feet at the Flat Iron Building, and Deloitte’s lease for 12,000 square feet at 38 Commerce Avenue.

Looking ahead to 2012, the CBD office market should see a slight increase in rental rates because of increased demand

and a shortage of large blocks of quality space. These factors will also cause the trend of decreasing landlord concessions to continue in the next year. Tenants will be signing longer-term leases due to growing confidence and bottomed out rental rates. Vacancy and absorption should remain relatively flat for the CBD next year. This is due to a number of buildings with “shadow space” that will come on the market in 2012. Shadow space refers to office space that is technically leased at the present time but not currently being utilized, or is physically vacant.

There was minimal ground-up construction completed throughout the year, although we saw more activity in 2011 than in recent memory. The largest completion of the year was a 370,000 square foot, three-story building for Farmer’s Insurance in Caledonia. This is expected to add 1,600 jobs and will house a call center, printing distribution center, and Farmer’s University. Another large project that broke ground was the new headquarters for Gordon Food Service on Gezon Parkway SW in Wyoming. More than 1,000 office workers will move to the new 382,000 square foot complex in 2012. Beyond this, we are seeing a trend of extensive rehabilitation projects such as law firm Smith Haughey Rice & Roegge’s renovation at the Flat Iron Building. Other noteworthy office renovations include 201 Lyon Avenue and 35 Oakes Avenue, which will be known as GRid35. GRid35 will be more than 50,000 square feet of collaborative office space, which grew from the success of its predecessor GRid70.

There is some potential for new office development projects to break ground in the next year; however, expect new construction to be limited beyond the completion of the Gordon Food Service building. In general, next year should mirror much of what we saw in 2011. The worst is over, but the recovery will be a long and drawn out process.

Grand Rapids | Retail Market

Last year we forecast that the retail market would bottom out and then look to gain from the bottom in the second part of the year. With a strong third and fourth quarter, we believe this prediction came to fruition. Absorption was positive for the year, and overall activity has generally picked up as well. As is true with many real estate transactions, the end result is often realized well down the road from its inception. This is important to keep in mind when analyzing the market. Market metrics have not yet started to climb back toward historical norms; however, projects are now underway which will eventually result in a trend back towards normalcy. In the meantime, landlords and tenants alike are looking to continue to weather the storm and position themselves better for the future.

The consumer confidence index climbed in November by the most it has in eight years, just in time for the holiday season. Also, unemployment in the area has dropped from 9% in November of 2010 to 6.5% in November of 2011, which should help consumer activity as well. Grand Rapids has been instrumental in leading Michigan out of the recession, as it continues to create unique opportunities for people to come downtown and spend money. Along with the open art competition ArtPrize, the city hosted a holiday celebration called Holly Jolly, which was intended to boost retail sales during the biggest spending period of the year.

As always, location has played a large role in the success of local retail operations. There are historically active submarkets, such as 28th Street SE and Alpine Avenue, that continue to see interest, while areas with less historical success continue to struggle. Now more than ever, market knowledge will be key to taking advantage of the opportunities in the market and will help create a game plan for the future. Capable tenants are attempting to lock in current rates while also looking at potentially upgrading their location, such as Best Buy on Alpine, which moved closer to the I-96/US-131 interchange in an attempt to attract more foot traffic. Landlords are giving fewer incentives due to their economic struggles, which will keep rates low and stable in order to still attract tenants. As tenants continue to lock in or upgrade, stressed retail areas will continue to struggle.

One solution to combat this issue is re-development or renovation. We have seen construction pick up from its non-existence last year, with ALDI and Lake Michigan Credit Union being finished at Knapp's Corner as well as

PF Changs and D&W Market in Knapp's Crossing just across the street. Baggar Dave's, a national restaurant chain, re-developed the old Big Boy on the corner of 28th Street and Kraft, while Smash Burger moved into locations on the Medical Mile downtown as well as in the former Blockbuster Video on the corner of 28th Street and East Beltline. In Breton Village, 22,000 square feet was added to the 180,000 square feet of recently remodeled retail space. Women's brand Anthropologie moved into roughly half of the new addition, and has already started quite the buzz about the retail center. Since the announcement of the new store, two new retailers have committed to taking space in the center in 2012. We look to see more activity in this area than in recent history.

As we close the book on 2011, we now look forward to 2012 and beyond. Activity in the marketplace is increasing, and we look for that to continue into the New Year. Many retailers are done sitting on the sidelines and look at the current situation as a time to gain an advantage. Ruben Ysasi, VP of business development for Subway of Western Michigan, maintains that now is the time to start taking risks again. He says, rather than be timid about the market, now is the time to "attack, attack, attack." Yasi advises, "Not doing anything is not the answer." In Grand Rapids, we see this sentiment broadly supported by the increase in activity from a year ago.

Projects underway that will have an influence in the future include the transformation of 400,000 square feet into a retail and office center in Grandville. The site was formerly the headquarters of X-Rite Corporation and has been in negotiation for re-development for years. Target has committed to be the anchor tenant, taking roughly 135,000 square feet, which will surely help the rest of the center lease up. Additionally, CenterPointe Mall will soon begin a two year "de-malling" process, which will see the mall trim roughly 350,000 square feet of floor space. The plans call for the removal of much of the southern side of the building including the interior mall, food court, and the former Klingman's furniture store. The building's owner, Bloomfield Hills-based Lormax Stern Development Co., plans to consolidate existing tenants for the alteration, as well as add new ones.

As the focus for many people has shifted from "shopping" to simply "buying," retailers are coming up with ways to make the experience quicker and easier. The advent of online shopping has helped make this possible, but has had a negative effect on physical stores. E-commerce now accounts for nearly 10% of the retail market share and we look for this to continue to have an impact going forward. Expect to see legislation proposed which would make it harder for online retailers to avoid state sales tax laws in an attempt to even the playing field as much as possible. Also, look to see more integration of restaurants and entertainment with merchandisers, as consumers look for more consolidated destinations.

We stated last year that the future of retail in West Michigan still remains bright due to our vibrant community and its commitment to local establishments. The healthy holiday season, coupled with increasing confidence in the market should get 2012 off to a nice start. Since we can now see the worst of the downturn in our rearview mirrors, we predict the upcoming year will build on the momentum captured at the end of 2011.

Property Management

2011 has been a year of transition in the property management world. As the economy continues to show signs of improvement, we are seeing more and more properties transition ownership. While banks continue to play a role, the troubled assets that are hitting the market today are not the truly distressed properties that were prominent in 2009 and 2010; they are decidedly higher quality Class A & B properties, well located and with fairly stable occupancy. Financial institutions understand the value in managing and maintaining these properties at a higher level and are not opposed to spending the money to make improvements and take care of deferred maintenance. With these properties hitting the market, property owners are recognizing the need to focus on operating efficiency, tenant retention and attention to detail to remain competitive.

As Asset Managers, we continue to closely monitor operating expenses and tenant rental payment patterns. With rental rates in certain segments still not back up to pre-recession levels, property owners are still focused on reducing expenses. However, for the first time in several years, owners are willing to look at creating efficiencies by investing in energy efficient fixtures, equipment, and operating system upgrades. We are also encouraged by the fact that more property owners are including capital improvement projects in their 2012 budgets. Some of this optimism may be inspired by the overwhelming popularity of ArtPrize. Downtown property owners and retail businesses want to advantage of the increased exposure by putting their best foot forward for the community.

2011 also brought an increased demand for facility management and maintenance services. This has been an area of significant growth as more and more institutions are under close public and/or stakeholder scrutiny. We are projecting this trend will continue as outsourcing and reduced corporate/government spending appear to be the new “norm.”

Improving consumer confidence, stabilizing rental rates and increasing real estate investment activity are all positive signs for our market. We are strongly encouraged by the momentum heading into the New Year.

As more real estate is expected to change hands in 2012, we anticipate the re-positioning of many properties. New owners who were able to take advantage of “bargain prices,”

will be in a position to invest in new infrastructure, capital improvements, and aesthetic updates to create a new image for those properties stigmatized by vacancy, foreclosure, or other financial troubles.

With the return of more traditional ownership structures (non-bank owned), will come tenant stability. Tenants who have grown weary of inconsistent service, deferred maintenance, and general lack of attention will be happy to see responsible operating practices come back into style. Tenant retention will still be the name of the game, but stable ownership and reliable management systems will make that much easier. ■